All Cap Index & Sectors: Free Cash Flow Yield Through 3/11/22 (Free, Abridged)

This report is an abridged and free version of All Cap Index & Sectors: Free Cash Flow Yield Through 3/11/22, one of our quarterly reports on fundamental market and sector trends.

Key points:

- Eight NC 2000[1] sectors saw an increase in trailing FCF yield from 3/31/21 to 3/11/22.
- With a 5.9% FCF Yield, investors are getting more FCF for their investment dollar in the Basic Materials sector than any other sector as of 3/11/22. The Real Estate sector, at -3.5%, currently has the lowest trailing FCF yield of all NC 2000 sectors.
- The full version of this report analyzes[2,3] free cash flow (FCF), enterprise value, and the trailing FCF yield for the NC 2000 and each of its sectors (last quarter's analysis is here). These reports are available to clients with a Pro or higher membership or can be purchased here.

All of our reports leverage more reliable fundamental data[4] that overcomes flaws with legacy fundamental datasets to provide a more informed view of macro fundamentals and a new source of alpha.

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NC 2000 Trailing FCF Yield Rises from 3/31/21 to 3/11/22

The trailing FCF yield for the NC 2000 rose from 0.9% as of 3/31/21 to 1.6% as of 3/11/22. Eight NC 2000 sectors saw an increase in trailing FCF yield from 3/31/21 to 3/11/22. See Figure 1 in the full version of our report for the chart of FCF Yield for the NC 2000 from December 1998 through 3/11/22.

With a 5.9% FCF Yield, investors are getting more FCF for their investment dollar in the Basic Materials sector than any other sector. The Basic Materials, Financials, Healthcare, Industrials, Telecom Services, Utilities, Energy, and Consumer Non-cyclicals sectors each saw an increase in trailing FCF yield from 3/31/21 to 3/11/22.

Below, we highlight the Financials sector trailing FCF yield.

[1] The NC 2000, our All Cap Index, consists of the largest 2000 U.S. companies by market cap in our coverage. Constituents are updated on a quarterly basis (March 31, June 30, September 30, and December 31). We exclude companies that report under IFRS and non-U.S. ADR companies.
[2] We calculate these metrics based on S&P Global's (SPGI) methodology, which sums the individual NC 2000 constituent values for free cash flow and enterprise value before using them to calculate the metrics. We call this the "Aggregate" methodology.
[3] Our research is based on the latest audited financial data, which is the 2021 10-K in most cases. Price data is as of 3/11/22.
[4] Three independent studies prove the superiority of our data, models, and ratings. Learn more here.

Important Disclosure Information is contained on the last page of this report.
The recipient of this report is directed to read these disclosures.

Sample Sector Analysis[5]: Financials

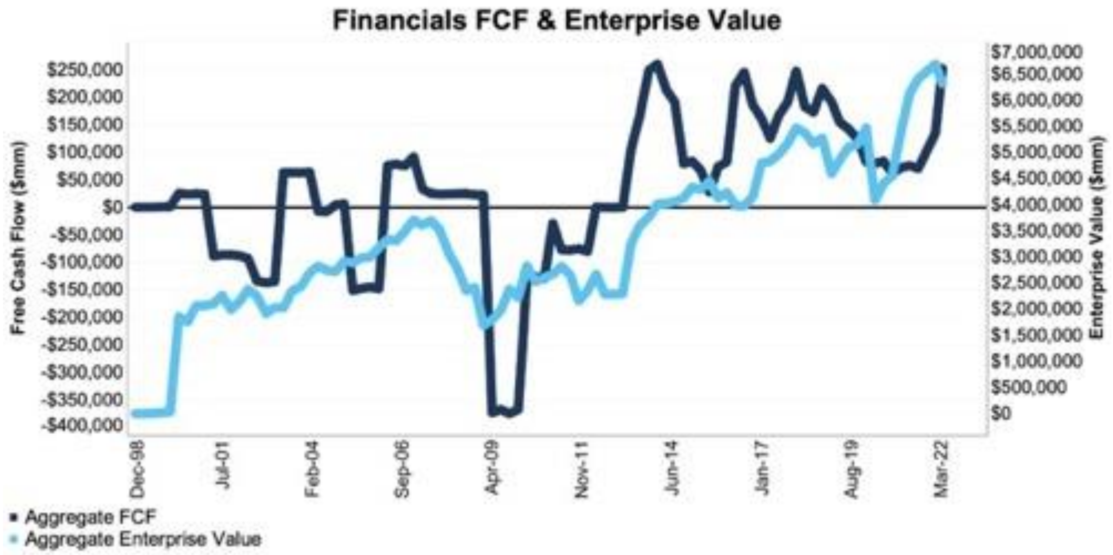
Figure 1 shows trailing FCF yield for the Financials sector rose from 1.2% as of 3/31/21 to 4.0% as of 3/11/22. The Financials sector FCF rose from $75.7 billion in 2020 to $251.9 billion 2021, while enterprise value increased from $6.1 trillion as of 3/31/21 to $6.3 trillion as of 3/11/22.

Figure 1: Financials Trailing FCF Yield: Dec 1998 – 3/11/22

Sources: New Constructs, LLC and company filings.
The March 11, 2022 measurement period uses price data as of that date and incorporates the financial data from 2021 10-Ks, as this is the earliest date for which all the 2021 10-Ks for the NC 2000 constituents were available.

Figure 2 compares the trends in FCF and enterprise value for the Financials sector since 1998. We sum the individual NC 2000/sector constituent values for free cash flow and enterprise value. We call this approach the "Aggregate" methodology, and it matches S&P Global's (SPGI) methodology for these calculations.

Figure 2: Financials FCF & Enterprise Value: Dec 1998 – 3/11/22



Sources: New Constructs, LLC and company filings.
The March 11, 2022 measurement period uses price data as of that date and incorporates the financial data from 2021 10-Ks, as this is the earliest date for which all the 2021 10-Ks for the NC 2000 constituents were available.

[5] The full version of this report provides analysis for all eleven sectors.

The Aggregate methodology provides a straightforward look at the entire NC 2000/sector, regardless of market cap or index weighting, and matches how S&P Global (SPGI) calculates metrics for the S&P 500.

For additional perspective, we compare the Aggregate method for free cash flow with two other market-weighted methodologies. Each method has its pros and cons, which are detailed in the Appendix.

Figure 3 compares these three methods for calculating the Financials sector's trailing FCF yields.

Figure 3: Financials Trailing FCF Yield Methodologies Compared: Dec 1998 – 3/11/22

Sources: New Constructs, LLC and company filings.
The March 11, 2022 measurement period uses price data as of that date and incorporates the financial data from 2021 10-Ks, as this is the earliest date for which all the 2021 10-Ks for the NC 2000 constituents were available.

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Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

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Appendix: Analyzing Trailing FCF Yield with Different Weighting Methodologies

We derive the metrics above by summing the individual NC 2000/sector constituent values for free cash flow and enterprise value to calculate trailing FCF yield. We call this approach the "Aggregate" methodology.

The Aggregate methodology provides a straightforward look at the entire NC 2000/sector, regardless of market cap or index weighting, and matches how S&P Global (SPGI) calculates metrics for the S&P 500.

For additional perspective, we compare the Aggregate method for free cash flow with two other market-weighted methodologies. These market-weighted methodologies add more value for ratios that do not include market values, e.g. ROIC and its drivers, but we include them here, nonetheless, for comparison:

1. **Market-weighted metrics** – calculated by market-cap-weighting the trailing FCF yield for the individual companies relative to their sector or the overall NC 2000in each period. Details:
    a. Company weight equals the company's market cap divided by the market cap of the NC 2000/ its sector
    b. We multiply each company's trailing FCF yield by its weight
    c. NC 2000/Sector trailing FCF yield equals the sum of the weighted trailing FCF yields for all the companies in NC 2000/sector
2. **Market-weighted drivers** – calculated by market-cap-weighting the FCF and enterprise value for the individual companies in each sector in each period. Details:
    a. Company weight equals the company's market cap divided by the market cap of the NC 2000/ its sector
    b. We multiply each company's free cash flow and enterprise value by its weight
    c. We sum the weighted FCF and weighted enterprise value for each company in the NC 2000/each sector to determine each sector's weighted FCF and weighted enterprise value
    d. NC 2000/Sector trailing FCF yield equals weighted NC 2000/sector FCF divided by weighted NC 2000/sector enterprise value

Each methodology has its pros and cons, as outlined below:

Aggregate method

Pros:

- A straightforward look at the entire NC 2000/sector, regardless of company size or weighting.
- Matches how S&P Global calculates metrics for the NC 2000.

Cons:

- Vulnerable to impact of companies entering/exiting the group of companies, which could unduly affect aggregate values. Also susceptible to outliers in any one period.

Market-weighted metrics method

Pros:

- Accounts for a firm's market cap relative to the NC 2000/sector and weights its metrics accordingly.

Cons:

- Vulnerable to outlier results from a single company disproportionately impacting the overall trailing FCF yield.

Market-weighted drivers method

Pros:

- Accounts for a firm's market cap relative to the NC 2000/sector and weights its free cash flow and enterprise value accordingly.
- Mitigates the disproportionate impact of outlier results from one company on the overall results.

Cons:

- More volatile as it adds emphasis to large changes in FCF and enterprise value for heavily weighted companies.

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Best Fundamental Data in the World

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Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

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